

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>MOHAMAD MEHDI AND</b>	:	DETERMINATION
<b>AZAR KESHAVARZ-ARSHADI</b>	:	DTA NO. 813019
	:	
for Redetermination of a Deficiency or for	:	
Refund of New York State Personal Income Tax	:	
under Article 22 of the Tax Law and New York	:	
City Personal Income Tax under the	:	
Administrative Code of the City of New York	:	
for the Years 1977, 1978 and 1979.	:	

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Petitioners, Mohamad Mehdi and Azar Keshavarz-Arshadi, 171 Devon Road, Colonia, New Jersey 07067, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law and New York City Personal Income Tax under the Administrative Code of the City of New York for the years 1977, 1978 and 1979.

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on September 26, 1995 at 11:00 A.M. Petitioners filed a brief which was received on January 3, 1996. The Division of Taxation's letter brief was received on February 1, 1996, and petitioners' letter brief in reply was received on February 26, 1996, which date began the six-month period for the issuance of this determination. Petitioners appeared by Sidney Finkelstein, CPA, and Karim Arzadi, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Herbert M. Friedman, Jr., Esq., of counsel).

***ISSUE***

Whether the Division of Taxation properly determined additional personal income tax due from petitioners by utilizing a cash availability audit methodology.

### ***FINDINGS OF FACT***

1. Petitioner Mohamad Mehdi Keshavarz-Arshadi, during the years at issue, practiced internal medicine in New York City. Dr. Keshavarz-Arshadi<sup>1</sup> testified that he came to the United States in 1967, and after a residency in Kingsbrook Jewish Medical Center in Brooklyn, he commenced a practice in internal medicine in New York City, with three offices, one in the Bedford-Stuyvesant section of Brooklyn located on Ralph Avenue, a second office on the first floor of his former home in Staten Island located on Clifton Avenue, and a third office on Van Duzer. Initially, Dr. Keshavarz-Arshadi testified that he established his third office on Van Duzer in 1978, but on cross-examination, he conceded that it might have been in 1977.

2. Dr. Keshavarz-Arshadi rented his Brooklyn office at a location where there were other medical offices, including the offices of a podiatrist, an ophthalmologist and a dentist, as well as a pharmacy. The doctor testified that he had three employees in his Brooklyn office, a radiologist, a receptionist and his wife, Azar Keshavarz. He would see on the average 20 to 25 patients a day at the Brooklyn office working from 9:00 A.M. to 3:00 P.M. and sometimes to 6:00 P.M. Unfortunately, Dr. Keshavarz-Arshadi did not describe his Brooklyn practice in positive terms or coherently:<sup>2</sup>

"The people that are there [Ralph Avenue in Brooklyn], they are all poor people. They are either on Medicare or Medicaid. Usually, there's not any private patients there. These people abuse the Medicaid and Medicare. So, they come and take a lot of nerve medicine, sleeping pills, some medicine that they don't use, for example, they use something sporting medicine. You say, 'My back hurt and you write for me this and write down for me that.' Then they go and sell it to market. Very, very cheap area. Or Zantac, for example, any kind of medicine that's money proof. Then they sell on the market. So, we are in the area that we are under tension a lot because one side I want to preserve the patient. We want to be sure that when I give medicine, this medicine is useful to the patient. The patient not abuse the medicine" (tr., p. 131).

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<sup>1</sup>Petitioner Azar Keshavarz-Arshadi, who is the wife of Mohamad Mehdi Keshavarz-Arshadi, testified that she uses the surname of Keshavarz because Keshavarz-Arshadi is "too long" (tr., p. 242). However, her husband is known as Keshavarz-Arshadi although it is observed that the doctor's signature on each of the New York income tax returns at issue (Division's Exhibit "K") shows his use of only Keshavarz as a surname. Consequently, in this determination petitioner Mohamad Medhi Keshavarz-Arshadi will be referred to as Dr. Keshavarz-Arshadi while petitioner Azar Keshavarz-Arshadi will be referred to as Mrs. Keshavarz. It is further noted that petitioners' attorney, who is their eldest son, is known by the surname of Arzadi.

<sup>2</sup>The English-speaking ability of Dr. Keshavarz-Arshadi is limited.

3. Dr. Keshavarz-Arshadi testified that he had private patients on Staten Island who paid him in cash at a rate of \$10 to \$15 per visit. It is unclear whether he saw these patients at the office in his home on Clifton Avenue or on Van Duzer. It appears that he saw them at his office on Van Duzer because Dr. Keshavarz-Arshadi testified that he used his office in his home to process his paperwork for Medicare and Medicaid for "two, three hours" (tr., p. 197) every night and did not specifically mention that he saw patients at his home office.

The doctor described the first floor medical office in his home on cross-examination as follows:

Attorney Friedman: "What did that office consist of?"

Dr. Keshavarz-Arshadi: "Front floor basement that make divided to the wait room, the patient come and the people sit down to visit doctor."

Attorney Friedman: "So, you had a waiting room and you had two or three examining rooms?"

Dr. Keshavarz-Arshadi: "Yes."

Attorney Friedman: "Did you have a reception area for someone to greet the people?"

Dr. Keshavarz-Arshadi: "Reception, same thing."

Attorney Friedman: "In the waiting room?"

Dr. Keshavarz-Arshadi: "Yes" (tr., pp. 193-194).

He described his office on Van Duzer, which was owned by his professional corporation by which he conducted his medical practice, as follows:

Attorney Friedman: "And what did that office consist of?"

Dr. Keshavarz-Arshadi: "That office was also a first-floor. That was old office of old doctor that I bought, and second floor, same doctor was leaving" (tr., p.194).

According to Dr. Keshavarz-Arshadi, he had no employees at the office in his home, and only a receptionist at his Van Duzer office where he apparently saw patients from "[f]our in the afternoon to six or seven" (tr., p. 196). However, a moment later in his cross examination, he testified, "I had some people [unidentified by the doctor] help me in this process [of preparing

paperwork for Medicare and Medicaid]" (tr., p. 197) so that he might have had some employees at the office in his home.

4. In 1986, Dr. Keshavarz-Arshadi retired from his practice of internal medicine at the age of 53. There is no explanation for this apparently premature retirement from his then 14 years of practice, which he had commenced in 1972.

Petitioners' Tax Returns

5. For each of the years at issue, Dr. Keshavarz-Arshadi and Mrs. Keshavarz filed separately on one tax return as married persons. In 1977, the doctor and his wife reported New York taxable income of \$22,919.00 and \$4,755.00, respectively, computed as follows:

	<u>Dr. Keshavarz-Arshadi</u>	<u>Mrs. Keshavarz</u>
Total New York income	\$33,909.00	\$5,405.00
Less: Itemized deduction	<u>3,840.00</u>	-0-
	\$ 30,069.00	\$5,405.00
Exemptions <sup>3</sup>	<u>7,150.00</u>	<u>650.00</u>
New York taxable income	\$22,919.00	\$4,755.00
New York State tax	\$ 1,769.00	\$ 150.00
New York City tax	\$ 592.00	\$ 69.00

The total New York income of Dr. Keshavarz-Arshadi and of Mrs. Keshavarz reported in 1977 of \$33,909.00 and \$5,405.00, respectively, consisted of the following as shown on Schedule A of their 1977 New York income tax return:

	<u>Dr. Keshavarz-Arshadi</u>	<u>Mrs. Keshavarz</u>
Wages	\$33,908.90	\$3,118.00
Interest income		<u>2,287.00</u>
Total New York income	\$33,908.90	\$5,405.00

Photocopies of wage and tax statements for 1977 show that the wages indicated above were received by the doctor and his wife from the doctor's professional corporation known as Mohamad M. Keshavarz Arshadi, M.D., P.C.

In Schedule B of the 1977 New York income tax return, petitioners computed itemized deductions of \$3,840.00, which were all allocated to Dr. Keshavarz-Arshadi, as follows:

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Dr. Keshavarz-Arshadi claimed 11 exemptions and Mrs. Keshavarz claimed one exemption on each of the returns at issue.

Medical and dental expenses	\$ 150.00
Taxes	5,982.00
Interest	171.00
Contributions	380.00
Miscellaneous	<u>120.00</u>
Total Federal itemized deductions	\$6,803.00
Less: income taxes included	<u>2,963.00</u>
New York itemized deduction	\$3,840.00

6. In 1978, the doctor and his wife reported New York taxable income of \$23,138.00 and \$4,273, respectively, computed as follows:

	<u>Dr. Keshavarz-Arshadi</u>	<u>Mrs. Keshavarz</u>
Total income	\$33,669.00	\$4,923.00
Net addition <sup>4</sup>	<u>644.00</u>	
Total New York Income	\$34,313.00	\$4,923.00
Less: Itemized deduction	<u>4,025.00</u>	-0-
	\$30,288.00	\$4,923.00
Exemptions	<u>7,150.00</u>	<u>650.00</u>
New York taxable income	\$23,138.00	\$4,273.00
New York State tax	\$ 1,782.00	\$ 131.00
New York City tax	\$ 601.00	\$ 60.00

The total New York income of Dr. Keshavarz-Arshadi and of Mrs. Keshavarz reported in 1978 of \$33,669.00 and \$4,923.00, respectively, consisted of the following as shown on Schedule A of their 1978 New York income tax return:

	<u>Dr. Keshavarz-Arshadi</u>	<u>Mrs. Keshavarz</u>
Wages	\$33,669.00	\$3,000.00
Interest income	<u>1,923.00</u>	
Total New York income	\$33,669.00	\$4,923.00

Photocopies of wage and tax statements for 1978 were not attached to the 1978 return introduced into evidence. Presumably, as in 1977, the wages indicated above were received by the doctor and his wife from the doctor's professional corporation.

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<sup>4</sup>Schedule C to the 1978 tax return shows how this net addition was calculated as follows:

Excess pension contributions	\$750.00
FICA	894.00
College tuition	<u>(1,000.00)</u>
Net addition	\$644.00

In Schedule B of the 1978 New York income tax return, petitioners computed itemized deductions of \$4,025.00, which were all allocated to Dr. Keshavarz-Arshadi, as follows:

Medical and dental expenses	\$ 150.00
Taxes	5,519.00
Interest	377.00
Contributions	410.00
Miscellaneous	150.00
Total Federal itemized deductions	\$6,606.00
Less: income taxes included	2,581.00
New York itemized deduction	\$4,025.00

7. In 1979, the doctor and his wife reported New York taxable income of \$21,517.00 and \$5,581.00, respectively, computed as follows:

	<u>Dr. Keshavarz-Arshadi</u>	<u>Mrs. Keshavarz</u>
Total income	\$33,957.00	\$ 6,281.00
Net subtraction <sup>5</sup>	(610.00)	
Total New York income	\$33,347.00	\$ 6,281.00
Less: Itemized deduction	4,130.00	-0-
	\$29,217.00	\$ 6,281.00
Exemptions	7,700.00	700.00
New York taxable income	\$21,517.00	\$ 5,581.00
New York State tax	\$ 1,582.00	\$ 189.00
New York City tax	\$ 539.00	\$ 85.00

The total New York income of Dr. Keshavarz-Arshadi and of Mrs. Keshavarz reported in 1979 of \$33,347.00 and \$6,281.00, respectively, consisted of the following as shown on Schedule A of their 1979 New York income tax return:

	<u>Dr. Keshavarz-Arshadi</u>	<u>Mrs. Keshavarz</u>
Wages	\$33,957.00	\$3,057.00
Interest income		1,879.00
State and local income tax refunds		388.00
Other income		957.00
Total New York income	\$33,957.00	\$6,281.00

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<sup>5</sup>On Schedule C to the 1979 return, the net subtraction of \$610.00 was calculated as follows:

Pension and FICA	\$1,503.00
State and local income tax refunds	(388.00)
Tuition deduction	(1,725.00)
Net amount	(\$610.00)

Photocopies of wage and tax statements for 1979 were not attached to the return introduced into evidence, but presumably such wages were received from the doctor's professional corporation.

In Schedule B of the 1979 New York income tax return, petitioners computed itemized deductions of \$4,130.00, which were all allocated to Dr. Keshavarz-Arshadi, as follows:

Medical and dental expenses	\$ 150.00
Taxes	5,804.00
Interest	524.00
Contributions	430.00
Miscellaneous	<u>185.00</u>
Total Federal itemized deductions	\$7,093.00
Less: income taxes included	<u>2,963.00</u>
New York itemized deduction	\$4,130.00

8. It is observed that petitioners each signed the tax returns at issue, and that they were prepared by an individual identified as Michael D. Sherman. His mailing address varied from West Dover, Vermont on the 1977 and 1978 returns to Pound Ridge, New York on the 1979 return. The returns in evidence do not indicate Mr. Sherman's professional status.

9. The 12 exemptions claimed by petitioners as well as the low amount of income reported for a physician apparently was a "red flag" for the Division of Taxation ("Division") to take a close look at petitioners' tax returns, and an audit appointment letter dated September 26, 1980 (Division's Exhibit "J") commenced the audit. Grace Dunn, the auditor who completed in 1983 the cash availability audit of petitioners which is at issue (12 years prior to the date of her testimony at the hearing), after reassignment from a prior auditor, Michael Lamberti, testified:

"One wonders how--it's not an awful lot of money, when you have 10 children, to live on. So, therefore, because--it kind of puts--you just stop to think, you say, 'Wow. That's not very much' (tr, p. 35).

It is observed, nonetheless, that after audit, the auditor allowed the number of exemptions claimed by petitioners.

10. Auditor Dunn described a cash availability analysis as follows:

"[W]e take all the funds coming in and all the funds going out, and we look to see if people have enough for cash living expenses . . . . We look for transfers from one account to another account. We look if the bills are all paid through their checking account, what is deposited to the checking account, and how much money they have to pay those everyday expenses" (tr., p. 22).

11. Included in the Division's Exhibit "M", the audit work papers, is a schedule, at pages numbered 3 and 3a, labelled "Cash Availability Analysis" which auditor Dunn described as follows:

"The top part is the cash in, the bottom part is the cash out . . . [T]he result was a shortage in all three years as far as money for living expenses" (tr., p. 36).

This key schedule provided the following detail:

	<u>1977</u>	<u>1978</u>	<u>1979</u>
Cash In:			
Net wages of Dr. Keshavarz-Arshadi	\$24,809.00	\$24,463.00	\$24,420.00
Net wages of Mrs. Keshavarz	2,750.00	2,626.00	2,680.00
Returned checks	477.00	485.00	-0-
Transfers from checking	1,500.00	-0-	-0-
Checks to cash and food stores <sup>6</sup>	8,549.00	5,953.00	3,732.00
Income tax refunds	683.00	837.00	1,471.00
Withdrawn from savings banks	44,500.00	24,586.00	2,400.00
Withdrawn from savings banks not related to funds out	<u>(44,000.00)</u>	<u>(24,586.00)</u>	<u>(2,400.00)</u>
Total	\$39,268.00	\$34,364.00	\$32,303.00
Cash out:			
Deposits to Citibank personal checking account	\$26,206.00	\$23,716.00	\$ 5,290.00
Deposits to Staten Island <sup>7</sup>	-0-	-0-	12,975.00
Deposits to savings banks	54,878.00	5,382.00	2,456.00
Total deposits	\$81,084.00	20,098.00	20,731.00
Cash availability (shortage)	(\$41,817.00)	\$ 5,266.00	\$11,582.00
Cash expenditures:			
Personal living expenses	\$21,000.00	\$24,580.00	\$23,580.00
Shortage per cash availability			

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The auditor's handwriting is not always easily decipherable. The word "stores" is a best guess. It is also observed that the auditor never explained the nature of this entry, and the schedule, referenced as a back-up, is not relevant to this entry. Although speculative, perhaps these amounts represent checks written on the business checking account of the professional corporation in payment of petitioners' personal expenses. Petitioners did not question the auditor concerning this particular entry.

7

On the auditor's schedule following the words "Staten Island" is apparently an account number 09-107827. However, the page reference on this schedule, for a back-up schedule on page "5", is incorrect. Rather, the back-up schedule is designated page "9". Auditor Dunn testified that up until April 1979, petitioners' personal checking account was with Citibank, then changed to Staten Island Savings. It is further observed that, in fact, none of the pages listed under the column "Ref", apparently an abbreviation for reference page, correspond to the backup worksheets included in Exhibit "M".



audit	(\$62,817.00)	(\$19,314.00)	(\$11,998.00)
Less:			
Redeposit Account 5-052312	\$17,000.00	-0-	-0-
Repaid by Corporation			
Downpayment Corp. prop.	\$17,000.00	-0-	-0-
Withdrawal from Savings	\$ 3,000.00		
Municipal bond interest	-0-	950.00	1,900.00
Shortage	\$25,817.00	\$18,364.00	\$10,098.00

It is observed that initially, in her analysis, the auditor determined a shortage, which she defined as "more funds going out than were coming in" (tr., p. 36), of \$62,817.00 for 1977. However, she then credited against this shortage a total amount of \$37,000.00. The basis for such adjustment was explained as follows:

"Where you see the redeposits of \$17,000.00 and repaid corporation \$17,000.00, those were reductions from my original shortage, and we picked that up from this page here [p. 8 of the work schedules marked into evidence as the Division's Exhibit "M"], withdrawals not related to funds out. You'll see the first figures, \$17,000.00, and then the next two [\$13,000.00 and \$4,000.00, both of these withdrawals are dated May 16, 1977] come to \$17,000.00" (tr., p. 40).

The auditor did not explain the specific basis for the \$3,000.00 credit against her original shortage for 1977, but it is observed that such adjustment was advantageous to the petitioners.

12. As noted in Finding of Fact "11", the auditor in calculating a shortage of funds utilized personal living expenses of \$21,000.00, \$24,580.00 and \$23,580.00 for 1977, 1978 and 1979, respectively. However, the back-up worksheet, which is page 17 of Exhibit "M", shows "approximate" amounts for personal living expenses of \$22,580.00, \$24,580.00 and \$25,000.00<sup>8</sup> for 1977, 1978 and 1979, respectively, calculated as follows:

Expenditure <u>Items</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
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<sup>8</sup>Although workpaper reflects totals of 22,580.00; 24,580.00 and 25,000 for 1979, 1978 and 1979, respectively, the actual totals are 22,080.00, 24,074.00 and 26,300 for 1977, 1978 and 1979, respectively.

Food <sup>9</sup>	\$10,400.00	\$10,400.00	\$10,400.00
Outside meals	500.00	500.00	500.00
Repairs (home)	500.00	500.00	500.00
Laundry-dry cleaning	500.00	500.00	500.00
Domestic help	800.00	800.00	800.00
Auto Expense	2,300.00	2,300.00	2,300.00
Transportation	500.00	500.00	500.00
Recreation-entertainment	1,000.00	1,000.00	1,000.00
Vacation-travel			1,500.00
Education-college tuition			1,000.00
Magazines-papers-books	500.00	500.00	500.00
Life insurance	500.00	500.00	500.00
Personal-tobacco, liquor			
lunches	2,000.00	2,000.00	2,000.00
Clothing	1,000.00	1,000.00	1,000.00
Contributions	380.00	380.00	-0-
Gifts	1,000.00	1,000.00	
Unusual expenses <sup>10</sup>	200.00	1,150.00	1,000.00
Real estate taxes		1,044.00	
Car purchase			<u>1,600.00</u>
Totals	<u>\$22,080.00</u>	<u>\$24,074.00</u>	<u>\$26,300.00</u>

13. The auditor rejected petitioners' contention that they were using monies repaid to the doctor from his professional corporation to live on. She emphasized that she could not follow numbers provided by petitioners for an alleged loan account and that the professional corporation's balance sheets shown on its Federal tax returns did not disclose a loan account. Nor did petitioners provide any loan documents.

14. Included in the Division's Exhibit "N" are photocopies of the Federal income tax returns filed by the doctor's professional corporation for the years ending June 30, 1978, June 30, 1979 and June 30, 1980 in which M.M. Keshavarz Arshadi M.D. P.C. reported gross receipts or gross sales of \$119,655.00, \$98,535.00, and \$90,829.00, respectively. It is observed that on each of these returns Schedule L, Balance Sheets, Schedule M-1, Reconciliation of Income Per Books With Income Per Return, and Schedule M-2, Analysis of Unappropriated Retained Earnings Per Books, were left blank with the words "Cash Basis" written across such schedules. Each of these returns was signed by the doctor in his capacity of president of the professional corporation. Mr. Sherman signed each of the returns as the paid preparer.

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<sup>9</sup>The auditor testified that she estimated food expense by using a figure of \$200.00 per week for food (tr., p. 50).

<sup>10</sup>The word "unusual" is a best guess since the photocopying cut off part of the word.

15. The auditor also rejected petitioners' contention that third parties "advanced or had given the doctor funds" because unsworn letters from such third parties was insufficient proof (tr., p. 61).

16. The Division issued a Statement of Personal Income Tax Audit Changes dated December 7, 1983 against petitioner, Mohamad M. Keshavarz-Arshadi asserting additional tax due of \$2,822.98, \$4,270.44 and \$2,660.42 plus interest for 1977, 1978 and 1979, respectively, calculated as follows:

	<u>1977</u>	<u>1978</u>	<u>1979</u>
Section 612(b) modification-Fica	\$ 817.00	-0-	-0-
Constructive dividend from Arshadi, M.D., P.C. less exclusion <sup>11</sup>	12,809.00	21,971.00	14,131.00
Interest income <sup>12</sup>	<u>1,144.00</u>	<u>962.00</u>	<u>940.00</u>
Net adjustment	\$14,770.00	\$22,953.00	\$15,071.00
Taxable income previously stated	<u>\$22,919.00</u>	<u>\$23,138.00</u>	<u>\$21,517.00</u>
Corrected taxable income	\$37,689.00	\$46,091.00	\$36,588.00
Tax on Corrected taxable income	\$ 3,963.35	\$ 5,071.53	\$ 3,608.14
New York City tax	1,220.63	1,581.91	1,173.28
Corrected tax due	\$ 5,183.98	\$ 6,653.44	\$ 4,781.42
Tax previously computed	<u>2,361.00</u>	<u>2,383.00</u>	<u>2,121.00</u>
Total additional tax due	\$ 2,822.98	\$ 4,270.44	\$ 2,660.42
Interest	1,632.73	2,097.99	1,075.29
Total	4,455.71	6,368.43	3,735.71

17. The Division issued a Notice of Deficiency dated April 6, 1984 against petitioner Mohamad Mehdi Keshavarz-Arshadi asserting additional tax

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It would appear that there was some other basis for the issuance of the Statement of Personal Income Tax Audit Changes than the cash availability audit. The Division's Exhibit "M" also includes work schedules related to an audit of the doctor's professional corporation.

12

Interest income reported by Mrs. Keshavarz was reallocated by the Division to the doctor. A corresponding Statement of Personal Income Tax Audit Changes dated December 5, 1983 issued to Mrs. Keshavarz shows a credit or refund of tax due to her after such reallocation.

due for 1977 and 1978 totalling \$6,970.90.<sup>13</sup> It is noted that the total additional tax due shown on the Statement of Personal Income Tax Adjustment as noted in Finding of Fact "16" for 1977 and 1978 is \$2,822.98 and \$4,270.44, respectively, which adds up to \$7,093.42. Why there is a difference of \$122.52 between the \$7,093.42 asserted in the statement and the lesser amount asserted in the Notice of Deficiency of \$6,970.90 was not explained. The Division also issued a second Notice of Deficiency dated April 6, 1984 against petitioner Mohamad Mehdi Keshavarz-Arshadi asserting additional tax due for 1979 of \$2,598.60. Once again it is unexplained why the lesser amount asserted due in the Notice of Deficiency of \$2,598.60 varies, in this instance, by \$61.82 from the amount asserted due in the Statement of Personal Income Tax Audit Changes of \$2,660.42.

The parties both argued in their briefs whether penalties were properly imposed on petitioners when, in fact, penalties were not imposed by the notices of deficiency. However, as noted in Finding of Fact "19", it is observed that the Division's collection notice asserted penalties due. There is no explanation in the record why the Division asserted such penalties when the notices of deficiency did not assert penalties.

18. Doctor Keshavarz-Arshadi filed a petition for redetermination of the deficiencies detailed in Finding of Fact "17" with the former Tax Appeals Bureau. However, a Default Order dated March 6, 1987 (Division's Exhibit "G") was issued against the doctor for the following reason:

"Under Section 601.5 of the State Tax Commission Rules of Practice and Procedure, a notice was served on the representative of the petitioner to file a perfected petition. Notice to file the perfected petition was sent to the representative's last known address. Petitioner failed to file a perfected petition. A default has been duly noted."

19. Six years later (and the record does not disclose any information concerning what transpired during this six-year period), the Division sought to collect the taxes asserted due plus penalty and interest by the issuance of a Consolidated Statement of Tax Liabilities dated July 15, 1993 which asserted the following amounts:

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<sup>13</sup>The dollar digit is unclear on the photocopy of this notice marked into evidence as the Division's Exhibit "F" and the "0" used above for the dollar digit is a best guess.

<u>Tax period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Credits</u>	<u>Current balance due</u>
1977	\$ 607.63	\$1,621.62	\$151.50	-0-	\$ 2,380.75
1977	2,148.79	5,631.39	531.36	187.00	8,124.54
1978	963.51	2,386.27	240.50	-0-	3,590.28
1978	3,250.97	8,052.29	812.50	-0-	12,115.76
1979	615.82	981.09	153.50	1,014.00	736.41
1979	1,982.78	4,527.06	495.50	-0-	7,005.34
Total					\$33,953.08

20. Some short, but unspecified, time after the issuance of the Consolidated Statement of Tax Liabilities, petitioners paid the amount asserted due. The Division introduced into evidence as its Exhibit "D", photocopies of three refund claims filed by petitioners for each of the years seeking refunds of \$10,505.29, \$15,706.04 and \$7,741.75 for 1977, 1978 and 1979, respectively. In addition, on the line where petitioners specified the amount of their refund claim they indicated they were also seeking the following amounts: "est.200" for 1977, "est.250" for 1978, and "est. 150" for 1979. Although unexplained, presumably, "est." is an abbreviation for estimated and the amounts represent additional interest. The petition (Division's Exhibit "B") specified \$34,413.81 as the total amount of the refund claim. It is noted that the total of \$10,505.29, \$15,706.04 and \$7,741.75 is \$33,953.08. Adding in the three estimated amounts of \$200, \$250 and \$150 gives a total of \$34,553.08.

21. Each of petitioners' refund claims provide the same "reasons for claim" as follows:

"During the initial audit, taxpayer awaited word from the State of New York so as to present the following issues, but the state never corresponded [sic] with taxpayer, who wishes to do so now since he has paid his tax assessments to the State of New York for the tax year under discussion.

The State of New York used the income method to determine how much the taxpayer needed to live on. However, the State of New York neglected to be aware of deductions applicable to taxpayer's corporation (office area used by corporation) which should not have been subject to taxpayer statement of annual estimated personal and family expenses.

Ergo, the State of New York is duplicating funds required for the taxpayer to live on. In addition, taxpayer received funds from other sources for additional living expenses (per affidavits subsequently [sic] received by taxpayer) which previously were not taken into account by N.Y. during its audit review" (Division's Exhibit "D").

22. By a letter dated May 6, 1994, which is attached to the petition (Division's Exhibit "B"), the Division denied petitioners' refund claims for a procedural reason:

"The audit division has no authority to act on a Notice of Default Order once it has been issued."

23. In light of the allegation in petitioners' refund claims that the Division "never corresponded [sic] with taxpayer", it is important to review the auditor's log, or chronology of contacts, which includes the following relevant entries concerning the auditor's attempt to obtain information in order to conduct the audit:

<u>Date</u>	<u>Contacts and Comments</u>
3/13/81	Mailed letter to representative requesting additional info
5/13/81	Call Mr. Sherman [petitioners' former representative], not in, left message
5/14/81-5/15/81	Called T/P's rep- no answer
6/5/81	Met with Mr. Michael Sherman . . . Examined cancelled checks, statements, cash receipts. . . .
6/6/81	Will discuss case with Supervisor, since it appears that T/P will probably be getting refunds
12/10/82 <sup>14</sup>	With Team Leader met with accountant, M. Sherman. Went over records he had available and left him with . . . list of items necessary to complete audit
1/4/83	Spoke to Sherman-is meeting with Dr. next week
1/15/83	At accountant's office with team leader. Personal checking account and cancelled checks, additional corporation statements
2/9/83	At accountant's office-transcribed personal savings accounts- requested information still missing- did Cost of Living on T/P- cash availability analysis . . . . Have requested personal savings accounts of audit years several times without success
3/9/83	Sent letter to accountant specifying once again exact information required

After five more attempts to schedule an appointment with petitioners' accountant, and the accountant's cancellation of one appointment, the auditor met with the accountant on July 13, 1983, and the relevant entries continued as follows:

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<sup>14</sup>This entry, and the ones that follow, were made by auditor Dunn to whom this audit was reassigned on October 21, 1982 from auditor Lamberti, who had made the intriguing entry of June 6, 1981 noted above that suggested a refund would probably be due to petitioners.

- 7/13/83      Finished cash availability analysis and presented to accountant-had to explain in detail. He became very agitated- said IRS is auditing TP for 79,80, &81 and came up with only minor adjustments. . . . Is contacting TP to find out about non-taxable income. I'm giving him another week.
- 8/12/83      Received letter from taxpayer explaining some deposits to personal savings
- 8/15/83      Wrote letter to TP suggesting he come into office to discuss audit.
- 8/26/83      At taxpayer's home-went over all items of cash availability analysis. His records are very poor-his loan account was presented- very hard to understand.

***Petitioners' Presentation***

24. Given the confusing<sup>15</sup> presentation made by petitioners, it is first reasonable to attempt to outline petitioners' substantive position and then compare the proof introduced by petitioners at the hearing. As noted in Finding of Fact "20", in their refund claims, petitioners' substantive contentions consisted of only the following:

(1) Certain expenses treated by the auditor as personal expenses were, in fact, business expenses of the professional corporation and should not have been included in the estimate of petitioners' personal and family expenses; and (2) petitioners received funds from other sources such as friends and relatives which were not considered by the auditor.

In their petition dated July 26, 1994, petitioners made the two allegations noted above and also asserted that the auditor also failed to consider the following additional sources of funds:

- (3) Reduction in bank balances;
  - (4) Funds drawn from the professional corporation for personal use;
  - (5) Funds available from tax refunds,
  - (6) Financing made available to petitioners, and
- (7) The obscure allegation of "spendable income available to taxpayers as reflected on their income tax filings."

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<sup>15</sup>In particular, petitioners' attorney appeared to believe mistakenly that if he could prove adequate books and records, the auditor improperly resorted to a cash availability audit (tr., p. 96).

It is observed that petitioners failed to allege in their petition their substantive complaint that the auditor erroneously calculated their personal expenses, which had been asserted by them in their Request for Conference dated June 2, 1994. Further, petitioner's attorney in his opening statement merely pointed out that, with the assistance of accountant Sidney Finkelstein, petitioners "have discovered numerous errors in the audit, the assessment [sic] of the funds [the auditor] lists as available" (tr., p.17).

25. Petitioners offered the testimony of Dr. Keshavarz-Arshadi. He testified that he received cash from patients during the three years at issue amounting to approximately \$30,000.00, and, in response to leading questions, stated that he reported all of it as income of his professional corporation (tr., p. 138). Petitioners introduced a small "daily planner" (Petitioners' Exhibit "4") which the doctor testified listed all the cash he received from patients. He also responded affirmatively to the question whether he reported "cash you received from that apartment rental on Van Duzer" (tr. p. 138). Focusing on a withdrawal of \$8,000.00 from a personal savings account on November 25, 1977, the doctor testified affirmatively to the leading question, "So, even though you didn't get credit for it, it's your money. You had it in '76, and you did what you wanted with it in '77" (tr., p. 139).<sup>16</sup>

The doctor also testified that he received repayments from his professional corporation for loans that he had made to it. However, other than what is an indecipherable log kept by the doctor (Petitioners' Exhibit 3), there were no loan documents, and the doctor's testimony was, like the log, not intelligible (tr., p. 144-145).

Through Dr. Keshavarz-Arshadi's testimony, petitioners' introduced into evidence, as their Exhibit "10", photocopies of statements from various individuals residing in Iran to the effect that the doctor served as an intermediary for the passing of funds on, from someone in Iran to a relation in the United States. In addition, the father of Mrs. Keshavarz signed a

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<sup>16</sup>The auditor on her cross-examination had testified as follows why she did not take the \$8,000.00 into consideration in her cash availability audit:

"When one takes a big sum like \$8,000.00 out of the bank, they usually don't use it for daily living expenses. They usually buy something." (tr., p. 118.)



statement that he paid for the expenses of petitioners and their family while they were in Iran for three months during the summer of 1979. These statements were allegedly witnessed but were not notarized. It is also observed that petitioners who retained their exhibits after the hearing, in order to make copies, apparently misplaced page 5 of the 12 pages marked as Exhibit "10" and substituted a photocopy of a statement that had been marked separately as petitioners' Exhibit "17" to add to the confusion. Furthermore, on questioning by the Division's representative during a voir dire, Dr. Keshavarz-Arshadi was forced to concede that he "possibly" wrote in the amounts of money specified in the various statements:

Attorney Friedman: "Did you write in the numbers yourself?"

Dr. Keshavarz-Arshadi: "No."

Attorney Friedman: "You wrote in the numbers in what is known as Petitioners' Exhibit "4"?"

Dr. Keshavarz-Arshadi: "What?"

Attorney Friedman: "Did you write the numbers in Petitioners' Exhibit "4"?"

Dr. Keshavarz-Arshadi: "Yes."

Attorney Friedman: "You filled out each and every page of this in your own handwriting?"

Dr. Keshavarz-Arshadi: "Right."

Attorney Friedman: "And do you realize there's remarkable similarity in the figures?"

Dr. Keshavarz-Arshadi: "Could be, but this is the figure I give them. If I wrote it, I wrote it."

Attorney Friedman: "So, it's possible that you filled these numbers in?"

Dr. Keshavarz-Arshadi: "I told them this is the amount; they wrote it down."

Attorney Friedman: "But you realize you're under oath today?"

Dr. Keshavarz-Arshadi: "Under oath."

Attorney Friedman: "So, it's your testimony that you possibly wrote these numbers in on these witness statements?"

Dr. Keshavarz-Arshadi: "It's possible" (tr., p. 174).

26. Petitioners also introduced into evidence, through the testimony of Dr. Keshavarz-Arshadi, a black notebook which was marked as petitioners' Exhibit "18", which the doctor described as follows:

"This is the book that has dealing with business. The cash, the checks that issued for business or for myself, and also deposits of checks in the account" (tr., p. 183).

The doctor contends that this book records all of the income and expenses of his professional corporation beginning on November 15, 1978, which is the date shown for the first check noted in the notebook.

27. Mrs. Keshavarz also testified at the hearing to support petitioners' position that the auditor's estimate of their personal living expenses was erroneous. According to Mrs. Keshavarz: (i) she gave haircuts to all of the family members, (ii) she bought used clothing by the bagful and used her seamstress skills to repair and maintain clothing, (iii) she bought food in bulk and from street-sellers, (iv) the family never ate restaurant food, and (v) petitioners never paid for domestic help or for a gardener.

28. Petitioners also presented the testimony of their accountant-representative, Sidney Finkelstein. It should be noted that Mr. Finkelstein had no personal knowledge of the facts at issue, but rather became involved in this matter approximately two to three years earlier. He reviewed the auditor's analysis and prepared his own analysis which was marked into evidence as petitioners' Exhibit "20". He determined that petitioners overreported their income by \$5,818.00, \$4,234.00 and \$1,929.00 for 1977, 1978 and 1979, respectively. It is observed that Mr. Finkelstein recomputed personal living expenses based upon the type of lifestyle described by Mrs. Keshavarz. It is fair to find that his schedule is not easily decipherable, and does not clearly follow the cash availability format utilized by the auditor, so that it is nearly impossible to compare his written analysis to the auditor's. Mr. Finkelstein's testimony was also hard to follow partly because the questioning on direct examination was confused.

29. Mr. Finkelstein did establish that the amount used by the auditor for petitioners' income tax refunds for 1977 of \$683.00 as noted in Finding of Fact "11" should be increased to \$1,414.00. As a result, the shortage calculated for 1977 of \$25,817.00 would be decreased by \$731.00.

30. The Division obtained permission at the hearing to submit an affidavit of the auditor in response to Mr. Finkelstein's analysis. Auditor Dunn's affidavit dated November 2, 1995, which was marked into evidence as the Division's Exhibit "P", reiterated (i) why she would not rely on the statements, detailed in Finding of Fact "25", (ii) why large withdrawals were not factored into a cash availability audit, as earlier detailed in footnote "16", (iii) why no alleged loan repayments were taken into consideration because of the lack of proper documentation, and (iv) why her estimate of cash living expenses was reasonable.

#### ***Procedural Permutations***

31. Petitioners obtained permission to submit an affidavit of Mr. Finkelstein in response to auditor Dunn's affidavit. However, a statement by Mr. Finkelstein dated December 29, 1995 was rejected by the administrative law judge because it was not in affidavit form and was submitted after the due date for its submission. In any event, petitioners' letter brief in reply mirrored Mr. Finkelstein's rejected statement.

32. Petitioners retained the exhibits introduced at the hearing in order to make copies. Initially, what was resubmitted to the administrative law judge were photocopies of the exhibits in a completely arbitrary sequence. They were rejected and returned to petitioners. Subsequently, the documents which had been marked as petitioners' exhibits at the hearing were returned to the administrative law judge. However, petitioners apparently added pages to the documents that had been marked as exhibits. The administrative law judge has not given any weight to these additional pages, some of which appear to be extra copies of other documents in the record.

#### ***SUMMARY OF THE PARTIES' POSITIONS***

33. In their brief, petitioners maintain that the doctor's recordkeeping was sufficient and consequently auditor Dunn had no basis to reconstruct petitioners' income. They also contend that they have introduced sufficient evidence to establish the doctor's loan account with his corporation and other revenue to explain any cash shortage. According to petitioners, the auditor had a duty "to follow up with the taxpayer to clarify the data presented" (Petitioners' brief, p. 3). Finally, petitioners maintain that penalties should not be imposed because "they had reasonable cause in good faith in relying on the information returns filed by an accountant, et cetera" (Petitioners' brief, p.3).<sup>17</sup>

34. The Division maintains that the cash availability audit was properly performed. The doctor's records were inadequate, failing to note any income from Medicare patients. In short, according to the Division, petitioners did not prove by clear and convincing evidence "the incorrectness of [the] deficiency" (Division's brief, p. 4).

35. In their brief in reply, petitioners point to the comment in the auditor's log, as noted in Finding of Fact "23", for June 6, 1981 that "it appears that T/P will probably be getting refunds". They also state that "at the end of the 7/8/83 division auditor's note, the team leader had also noted that the matter be concluded as per the auditor in charge, with a recommendation of no change" [emphasis in original] (Petitioners' reply brief p. 2). It is observed that such note by the team leader is not contained in the log introduced into evidence as part of the field audit report (Division's Exhibit "I"). Petitioners also allege that the auditor failed to consider many large transfers from the professional corporation to petitioners as set forth in Mr. Finkelstein's analysis. Petitioners also complain that the auditor did not "perform due diligence" in estimating petitioners' personal living expenses (Petitioners' reply brief, p. 3). In addition, the statements, as detailed in Finding of Fact "25" support a conclusion that petitioners had other sources of income. Petitioners maintain that the auditor had an obligation "to review the records provided her by the taxpayer" but she ignored their records (Petitioners' reply brief, p. 4).

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<sup>17</sup>The obscurity of this sentence is puzzling, but reflective of petitioners' presentation.

### ***CONCLUSIONS OF LAW***

A. The Tax Appeals Tribunal has recognized the validity of a cash availability audit to determine unreported taxable income (Matter of Lee, Tax Appeals Tribunal, October 11, 1990; Matter of R & J Automotive, Inc., Tax Appeals Tribunal, June 15, 1989). In fact, in income tax matters, it is not even necessary that the taxpayer's books and records be deemed inadequate before a source and application of funds audit may be conducted. In Matter of Lee (supra), the Tribunal noted that:

"[I]n Matter of Giuliano v. Chu (135 AD2d 893, 521 NYS2d 883). . . the court determined that '[a]n initial consideration of inadequate or incomplete books and records before employing an indirect method is normally only required in sales and use tax cases where the tax is imposed upon verifiable receipts evidenced by statutorily required books and records' [citation omitted]."

As noted in the Findings of Fact, much of petitioners' presentation involved their attempt to establish that the doctor's records concerning his receipts from his medical practice were accurate, and that the auditor arbitrarily refused to examine the doctor's records. However, even if such were the case, the auditor nonetheless properly resorted to a cash availability audit in order to verify income. Moreover, the detailing of the entries in the auditor's log, as noted in Finding of Fact "23", belies petitioners' allegation that the auditor arbitrarily refused to review the doctor's records. Rather, the log reflects remarkable patience on the part of the auditor, given the indecipherable nature of the doctor's recordkeeping.

B. Consequently, the issue to be resolved is whether petitioners have shouldered their burden of proving that the cash availability audit was erroneously performed. In Matter of Atlantic and Hudson Ltd. Partnership (Tax Appeals Tribunal, January 20, 1992), the Tribunal provided the following guidance concerning the burden of proof in matters before the Division of Tax Appeals:

"Although a determination of tax must have a rational basis in order to be sustained upon review (see, Matter of Grecian Sq. v. New York State Tax Commn., 119 AD2d 948, 501 NYS2d 219), the presumption of correctness raised by the issuance of the assessment, in itself, provides the rational basis, so long as no evidence is introduced challenging the assessment (see, Matter of Tivolacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174; Matter of Leogrande, Tax Appeals Tribunal, July 18, 1991). Evidence that both rebuts the presumption of correctness and indicates the irrationality of the audit may appear: on the face of the audit as

described by the Division through testimony or documentation (see, Matter of Snyder v. State Tax Commn., 114 AD2d 567, 494 NYS2d 183; Matter of Fortunato, Tax Appeals Tribunal, February 22, 1990); from factors underlying the audit which are developed by the petitioner at hearing (see, Matter of Ristorante Puglia, Ltd. v. Chu, 102 AD2d 348, 478 NYS2d 91; Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991 [where the petitioner proved that its utility meter readings bore no relationship to its level of business activity]); or in the inability of the Division to identify the bases of the audit methodology in response to questions posed at the hearing (see, Matter of Basileo, Tax Appeals Tribunal, May 9, 1991; Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991; Matter of Shop Rite Wines & Ligs., Tax Appeals Tribunal, February 22, 1991; Matter of Fashana, Tax Appeals Tribunal, September 21, 1989). However, where, as here, petitioner has failed to make any inquiry into the audit method or calculation, the presumption of correctness raised by the issuance of the assessment provides the rational basis for the assessment. To hold otherwise would be in irreconcilable conflict with the principles that the Division does not have the burden to demonstrate the propriety of its assessment (see, Matter of A & J Gifts Shop v. Chu, 145 AD2d 877, 536 NYS2d 209, lv denied 74 NY2d 603, 542 NYS2d 518; Matter of Blodnick v. New York State Tax Commn., 124 AD2d 437, 507 NYS2d 536, appeal dismissed 69 NY2d 822, 513 NYS2d 1027; Matter of Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113) and that the petitioner has a heavy burden to prove the assessment erroneous (see, Matter of Executive Land Corp. v. Chu, 150 AD2d 7, 545 NYS2d 354, appeal dismissed 75 NY2d 946, 555 NYS2d 692)."

C. In the matter at hand, petitioners have not established that the auditor erroneously refused to treat certain payments to Dr. Keshavarz-Arshadi as loan repayments from his professional corporation. Petitioners must bear the consequences of their inability to provide loan documents that would support their contention that the cash shortage determined by the auditor may be explained away by loan repayments. The confused testimony of the doctor and his indecipherable log is not adequate evidence (see, Bello v. Tax Appeals Tribunal, 213 AD2d 754, 623 NYS2d 363). Similarly, the statements which petitioners rely upon to establish that they served as intermediaries for funds flowing from third parties in Iran to other individuals in the United States, as well as the statement of the father of Mrs. Keshavara that he paid certain personal expenses of petitioners and their family, are insufficient proof of a nontaxable source of income which would explain the cash shortage. As noted in Finding of Fact "25", the doctor conceded that he "possibly" wrote the amounts into these statements. Moreover, the statements were not notarized. In short, such statements do not rise to the level of clear and convincing evidence to establish error on the part of the auditor (see, Bello v. Tax Appeals Tribunal, supra).

D. As for the auditor's estimate of petitioners' personal living expenses, given the size of petitioners' household, the auditor's estimate was reasonable. However, the testimony of Mrs. Keshavarz was sufficient to establish that petitioners did not incur an expense for (1) domestic help and/or a gardener and (2) outside meals, since she specifically denied that petitioners had such expenses, and this aspect of her testimony rang true. But with regard to the other expenses noted in Finding of Fact "12", Mrs. Keshavarz did not deny that petitioners incurred such expenses but rather challenged the amounts estimated by the auditor for such expenses. Her testimony alone did not provide a clear basis to decrease the amounts used by the auditor.

E. As noted in Finding of Fact "28", Mr. Finkelstein's alternative analysis, which was confused and failed to adequately follow the format utilized by the auditor, provides an insufficient basis to adjust the deficiency determined by the auditor. In addition, it is noted that the auditor's position, as noted in Finding of Fact "30", that large sums received by petitioners should not be treated as amounts available for daily living expenses, was reasonable and undercuts the heart of Mr. Finkelstein's analysis.

F. However, as noted in Finding of Fact "29", Mr. Finkelstein did establish that the amount used by the auditor for petitioners' income tax refunds for 1977 should be increased to \$1,414.00.

G. It is further concluded that the Division improperly imposed and collected penalties against petitioner in light of the fact, as noted in Finding of Fact "17", that the notices of deficiency did not assert penalties. Consequently, petitioners are entitled to a refund of the penalties which they have paid.

H. The fact that the prior auditor might have suggested that petitioners "will probably be getting refunds" in his log entry dated June 6, 1981, although intriguing, does not rise to the level of clear and convincing evidence to conclude that the deficiencies issued against petitioners by the Division were erroneous.

I. The petition of Mohamad Mehdi and Azar Keshavarz-Arshadi is granted to the extent indicated in Conclusions of Law "D", "F" and "G", and the Division is directed to recalculate

taxes due for the years at issue and to refund petitioners' overpayment of taxes as well as penalties erroneously collected plus any interest due on such amounts, but, in all other respects is denied.

DATED: Troy, New York  
August 8, 1996

/s/ Frank W. Barrie  
ADMINISTRATIVE LAW JUDGE